

Internal Audit



Entity Status Letter Process Review

July 13, 2010

Internal Audit Staff

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Entity Status Letter Process Review

July 13, 2010

To: Laureen Philipp, Director
Field and Complex Account Collection Bureau

From: Philip Yu, Director
Internal Audit Bureau

Entity Status Letter

Entity Status Letter:

An Entity Status Letter (ESL) states whether or not a business entity is in good standing with the Franchise Tax Board (FTB). The information in the ESL is public and does not reflect the entity's status with any other agency (e.g. the California Secretary of State). ESLs can be requested without restrictions at the public counter in FTB's California field offices. ESLs can also be requested through the mail.

FTB issues ESLs requested by a corporation or individual needing certification of the good standing of a given corporation or limited liability company (LLC) for the following purposes:

- The corporation's or LLC's legal status in court proceedings
- Any outstanding liability that would affect the corporation's or LLC's credit rating
- Verification of exempt status
- Corporation or LLC registers to transact business in another state

Eligibility Guidelines:

FTB issues ESLs for:

- Corporations
- Exempt organizations
- LLC's taxed as corporations, partnerships, or disregarded entities (e.g., single-member LLC's)

Fees:

FTB charges a \$20 fee per ESL. The following are exceptions to the fee:

- Erroneous ESL was previously issued
- Suspension in error (if requested within 30 days of restoration)
- The request is for an LLC taxed as a partnership or as a disregarded entity
- The request is received at a time the account is submitted for FTB revivor

Statistics

The FTB Los Angeles field office processed over 3,000 ESLs in 2009.

Purpose / Scope

The review of the ESL process within the Los Angeles field office was conducted in response to a whistleblower complaint filed with the Bureau of State Audits (BSA). The scope of the review covered ESLs issued by the Los Angeles field office in 2009 and 2010.

Objective

The objectives of the ESL process review included the following:

- Identify controls and determine the adequacy of the controls
- Identify risks and areas for improvement
- Propose recommendations to strengthen the controls within the process to safeguard FTB's assets and mitigate risks

Methodology

To achieve our audit objectives, the Internal Audit team:

- Conducted interviews with Los Angeles field office staff
- Observed the ESL process
- Obtained, reviewed, and analyzed ESL procedures, documentation, and reports

Results

The following is the auditor's finding and recommendations.

Finding	The ESL process lacks an audit trail, does not have adequate oversight, and is administered by incomplete procedures that could present the opportunity for fraudulent activities to go undetected.
Recommendations	<p>Short-term:</p> <ul style="list-style-type: none">• Remove the ESL (FTB 4263A) template from the FTB intranet.• Revise the ESL template.• Reduce access to the ESL (FTB 4263A) template to only designated staff assigned to process ESL requests (i.e. limited access folder on FTB server).• Clearly define and communicate expectations to management regarding accountability and oversight responsibilities over the Public Counter staff.• Revise ESL procedures to provide clear, step-by-step instructions on processing ESL's for both staff and supervisor. <p>Long-term:</p> <ul style="list-style-type: none">• Develop an on-line or web-based system where customers can request and pay for ESLs.

Other considerations:

- Consider increasing the cost of an ESL in accordance with California Revenue and Taxation Code Section 23305e(a) that states FTB may provide letters of good standing, verifying a corporation's status for doing business in California, at a charge reflecting the reasonable costs to the department in responding to these requests. Increasing the cost of an ESL will allow FTB to be in line with the actual market value for ESLs (i.e. couriers can charge anywhere up to \$200 per ESL).

Conclusion

We acknowledge that new procedures and controls were implemented subsequent to the BSA whistleblower complaint. However, based on our review, the effectiveness of the internal controls within the ESL process remains weak and inadequate.

Please inform Internal Audit in writing, of your efforts to implement the recommendations after 60 days, 6 months, and 1 year from the date of this final report. The information you provide us will be used to determine the need for a follow-up review.

Internal Audit greatly appreciates the cooperation and assistance provided to us by you and the Los Angeles field office staff during our review. If you have any questions, please contact Jasdeep Uppal at (916)845-5512, Douglas Hock at (916)845-7664, or Andrea VanWallegghem at (916)845-3488.

Philip Yu, Director
Internal Audit Bureau

cc: S. Stanislaus
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Appendix 1



Responses to Recommendations

The following is in response to the recommendations made by Internal Audit in a report regarding the Entity Status Letter (ESL) process as performed in the Los Angeles District Office. Responses follow each of the recommendations.

Short-term:

- RECOMMENDATION: Remove the ESL (FTB 4263A) template from the FTB intranet.
- RESPONSE: We are working with appropriate staff at FTB to move the 4263A from the Intranet to a password protected folder on a secure server where access will be controlled. One person and one back-up will be designated as the individual responsible for preparing ESLs in the field office. Only these designated individuals will have access to the form.
- RECOMMENDATION: Revise ESL template.
- RESPONSE: We are considering revising the template to provide extra controls and an audit trail. Numbering the letters and/or adding a signature line for supervisory approval are among the options being considered.
- RECOMMENDATION: Reduce access to the ESL (FTB 4263A) template to only designated staff assigned to process ESL requests (i.e. limited access folder on FTB server).
- RESPONSE: We are working with appropriate staff at FTB to move the 4263A from the Intranet to a password protected folder on a secure server where access will be controlled. One person and one back-up will be designated as the individual responsible for preparing ESLs in the field office. Only these designated individuals will have access to the form.
- RECOMMENDATION: Clearly define and communicate expectations to management regarding accountability and oversight responsibilities over the Public Counter staff.
- RESPONSE: This has already been done. The Regional Manager has met with all staff in the office to re-emphasize expectations. The Field and Complex Account Collection Bureau Director will be meeting with Los Angeles staff, supervisors and managers in July 2010, to again communicate expectations and answer questions where there may be a need.

- **RECOMMENDATION:** Revise ESL procedures to provide clear, step-by-step instructions on processing ESLs for both staff and supervisor
- **RESPONSE:** Procedures will be revised to include the specific process and roles for completing ESLs. New procedures will be documented, distributed and discussed with staff, supervisors and managers. Procedures will be reviewed and updated annually. If changes to the procedures are made in the annual review, those changes will be reviewed with appropriate staff, supervisors and managers.

Long-term:

- **RECOMMENDATION:** Develop an on-line or web-based system where customers can request and pay for ESLs.
- **RESPONSE:** Please see response under “Other Considerations”

Other considerations:

- **RECOMMENDATION:** Consider increasing the cost of an ESL in accordance with California Revenue and Taxation Code Section 23305e(a) that states FTB may provide letters of good standing, verifying a corporation’s status for doing business in California, at a charge reflecting the reasonable costs to the department in responding to these requests. Increasing the cost of an ESL will allow FTB to be in line with the actual market value for ESLs (i.e. couriers can charge anywhere up to \$200 per ESL).
- **RESPONSE:** In 2004 and in 2008, the Franchise Tax Board, reviewed fees charged for several different services. We are planning to undertake another evaluation of our fees in 2011. Increasing fees or assessing new fees, will, in some cases, require new or amended legislation. This would be a good time to include a proposal, for a web-based system that would accommodate requests and payment for many different services.

- **Internal Audit** is an integral part of Franchise Tax Board's business operations. We were established in 1981 by the Executive Officer to audit FTB's business functions.

We provide recommendations to the Audit Committee and senior management to improve operations and mitigate overall risk exposure. We are also the liaison between FTB and external auditors.